

APPENDIX C TO PART 37—WHAT IS THE DESIRED COVERAGE FOR PERIODIC AUDITS OF
FOR-PROFIT PARTICIPANTS TO BE AUDITED BY IPAS?

**Appendix C to Part 37-What is the Desired Coverage for
Periodic Audits of For-Profit Participants to be
Audited by IPAs?**

You may provide the following guidance to a for-profit participant and its IPA on the desired coverage of periodic audits.

COVERAGE OF INDEPENDENT AUDITS OF FOR-PROFIT FIRMS

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PART 1. GENERAL INFORMATION

What is the purpose of this document?

This document provides guidance for an independent public accountant (IPA) who is asked by a for-profit firm to conduct an audit of its systems, due to the firm's having received a technology investment agreement from the Department of Defense (DoD).

Why does the Federal Government need an audit?

Federal officials are accountable to the public for the resources provided to carry out Government programs. Financial auditing contributes to accountability by providing an independent assessment to assure that recipients are handling Government funds properly.

Can the audit be integrated with the regular audit of a firm's financial statements?

Yes, the intent is to cause the minimum possible disruption to the firm's activities, so the IPA is encouraged to do the needed transaction sampling for DoD awards as part of the regularly scheduled audit of the firm's financial statements. In some cases, it may be even more efficient and economical to separately audit the individual DoD awards, and the firm may elect to have the IPA do so.

What are the objectives of the audit?

The auditor is to determine and report on whether:

- The firm has an internal control structure that provides reasonable assurance that it is managing DoD awards in compliance with the award terms and conditions, including applicable Federal laws and regulations.
- Based on a sampling of DoD award expenditures, the firm has complied with award terms and conditions, including applicable Federal laws and regulations, that may have a direct and material effect on DoD awards.

What is the source of the requirement for the audit?

The source of the requirement stated in the award document stems from sections 37.640 through 37.660 of 32 CFR part 37, which is part 37 of the DoD Grant and Agreement Regulations (DoDGARs).

What should the IPA do if he or she finds that the Defense Contract Audit Agency is performing audits of the firm?

The IPA should consult with officials of the firm to ensure that:

- DoD agreements officers were aware of the DCAA audit presence at the time they made awards; and
- The DoD agreements authorize the IPA to perform the audit, rather than requiring that the DCAA do so. If the IPA is authorized to perform the audit, he or she must consider the nature, timing, and extent of his or her own auditing procedures, to avoid unnecessary duplication of the DCAA effort.

PART 2. AUDIT OBJECTIVES AND COMPLIANCE REQUIREMENTS

A. ALLOWABLE COSTS

What is the objective of this portion of the audit?

The objective is to determine, by testing a sample of transactions, whether the firm complied with the requirements concerning allowability of costs charged to DoD awards.

What standards or cost principles determine the costs that are allowable as charges to the award?

Each technology investment agreement should specify the standards or cost principles that the for-profit firm is to use to determine the costs that it is allowed to charge to that award. While the TIA may specify use of the for-profit cost principles in the Federal Acquisition Regulation (FAR, at 48 CFR part 31) and Defense FAR Supplement (DFARS, at 48 CFR part 231), it more likely will specify an alternative standard. The minimum standard in the latter case is that Federal funds and the firm's cost sharing contributions will be used only for costs that a reasonable and prudent person would incur in carrying out the research project contemplated by the agreement.

What compliance requirements for allowability of costs should the audit address?

For a firm that is subject to the cost principles in the FAR and DFARS, the IPA should determine and report on whether costs charged to DoD awards are in compliance with those cost principles and indirect cost rates are applied in accordance with approved rate agreements.

For a firm that is subject to alternative standards that may be used for a TIA, the IPA should determine and report on whether costs charged to the DoD awards are:

- Necessary and reasonable for the performance of the research projects supported by the awards, or for related administration. Generally, elements of cost that appropriately are charged are those identified with research and development activities under the Generally Accepted Accounting Principles (see Statement of Financial Accounting Standards Number 2, "Accounting for Research and Development Costs," October 1974).

- Allocable to the research projects (i.e., costs are charged to DoD projects in a manner that is in accordance with the benefits the projects received).
- Given consistent treatment with costs allocated to the firm's other research and development activities (e.g., activities supported by the firm itself or by non-Federal sponsors).
- In conformance with any limitations in the award documents or regulations that they cite (e.g., any restrictions on types or amounts of costs, or requirements for prior approval of DoD agreements officers).
- Supported by appropriate documentation in the firm's records. The documentation may be in electronic form.

B. COST SHARING

What is the objective of this portion of the audit?

The objective is to determine, by testing a sample of cost sharing contributions, whether the firm made the contributions that the agreements required.

What are the compliance requirements for cost sharing?

The provisions of the award documents will specify requirements for the firm's cost sharing, which may be contributions of a specified amount or a percentage of total project costs. The cost sharing may be in the form of allowable costs incurred or in-kind contributions (including third-party in-kind contributions).

The values of the firm's contributions are determined in accordance with sections 37.530 through 37.555 of 32 CFR part 37, which is part 37 of the DoDGARs.

C. FINANCIAL REPORTING

What are the objectives of this portion of the audit?

The primary objective is to determine whether the firm's financial reports for DoD awards:

- Fairly and completely represent the expenditures and status of resources for projects supported by those awards; and
- Are supported by applicable accounting records and the accounting basis used (e.g., cash or accrual).

What are the compliance requirements for financial reporting?

The agreements will specify the frequency and content of the financial reports. They may specify the use of standard forms (e.g., the Standard Form 269 or 269A, "Financial Status Report," or Standard Form 272, "Report of Federal Cash Transactions). Alternatively, the agreements may specify an equivalent approach of periodic reports, and the reports may include information on both programmatic and business status. The requirements are in section 37.880 of 32 CFR part 37, which is part 37 of the DoDGARS.

Each financial report (and the business portion of any report that also has programmatic information) will contain at least summarized details on the status of resources (Federal funds and any non-Federal cost sharing that the agreements require), including an accounting of expenditures for the period covered by the report. The report should compare the resource status with any payment and expenditure schedules or plans provided in the original award; explain any major deviations from these schedules; and discuss actions that will be taken to address the deviations.

D. EQUIPMENT AND REAL PROPERTY MANAGEMENT

Is a review of a firm's property management system usually required?

No, the IPA needs to review the property management system only if:

- There is Federally owned property associated with the award; or

- The firm charged the full purchase price of any equipment or real property as project costs (i.e., to Federal funds or the firm's funds that are counted toward required cost sharing); and
- The award under which the property was purchased provides for a continuing Federal interest in the property.

Note that the IPA generally will not need to review the property management system because most DoD awards will not have Federally owned property associated with them and will allow the firm to charge to the project only depreciation or use charges for real property or equipment.

What are the objectives of the review?

The objectives are to determine whether the firm:

- Obtained the necessary prior approval for the equipment or real property purchase from the grants officer or agreements officer.
- Keeps proper records for equipment and adequately safeguards and maintains equipment.
- Handles disposition or encumbrance of equipment or real property acquired under DoD awards in accordance with the applicable requirements.

What are the compliance requirements for Federally owned property and for equipment or real property purchased under DoD awards?

To protect the Federal interest in property, the DoD Grant and Agreement Regulations include standards for the firm's property management, use, and disposition, as shown in this table:

If the property is . . .	Then the property management standards for the for-profit firm are in . . .
Real property or equipment purchased under a TIA,	Section 37.685 of 32 CFR part 37.
Federally owned property,	Section 37.695 of 32 CFR part 37.

Note that a for-profit firm may include the full acquisition cost of real property or equipment as a charge to the project only with the prior approval of the grants officer or the agreements officer. The title to the real property or equipment vests conditionally in the for-profit firm upon acquisition, and there is a continuing Federal interest in the property unless an awarding office has statutory authority to do otherwise and elects to use that authority for a particular award. The Federal Government recovers its interest in the property through the disposition process at the project's end.

E. PROGRAM INCOME

Is an audit of program income usually required?

No, most awards will not involve any program income.

What is program income?

Program income is gross income earned by the recipient that is generated by a supported activity or earned as a result of the award. For example, if the purpose of an award is to support the firm's delivery of services and the firm collects fees for doing so, those fees are program income. As another example, if samples of materials or biological specimens are generated as a result of a supported research effort, and the firm sells samples to other research organizations, the proceeds of those sales would be program income. If authorized by the terms and conditions of the award costs incident to the generation of program income may be deducted from gross income to determine program income, provided these costs have not been charged to the award.

What is the objective of this portion of the audit?

The objective is to determine whether program income is correctly recorded and used in accordance with the award terms and applicable standards.

What are the applicable standards for program income?

The standards for program income are in section 37.835 of 32 CFR part 37, which is part 37 of the DoDGARs.

APPENDIX D TO PART 37—WHAT COMMON NATIONAL POLICY REQUIREMENTS MAY APPLY AND NEED TO BE INCLUDED IN TIAs?

Whether your TIA is a cooperative agreement or another type of assistance transaction, as discussed in Appendix B to this

part, the terms and conditions of the agreement must provide for recipients' compliance with applicable Federal statutes and regulations. This appendix lists some of the more common requirements to aid you in identifying ones that apply to your TIA. The list is not intended to be all-inclusive, however, and you may need to consult legal